OFFICE OF THE POLICE & CRIME COMMISSIONER FOR NORFOLK

ORIGINATOR: Chief Finance Officer	**Decision No:** 2014/07

REASON FOR SUBMISSION: For Approval

SUBMITTED TO: Police and Crime Commissioner

SUBJECT: Treasury Management Strategy for 2014/15

SUMMARY:

Government regulations require the PCC to approve an annual investment strategy prior to the start of the financial year. This is incorporated within an over-arching treasury management strategy. The strategy, which is outlined in this report, was included in the precept report, which was considered by the Police and Crime Panel (PCP) on 31st January 2014. The Audit Committee has also reviewed and endorsed the strategy.

RECOMMENDATIONS:

It is recommended that the PCC approves the Treasury Management Strategy for 2014-15.

OUTCOME/APPROVAL BY: PCC

The recommendation as outlined above is approved.

Signature S. W. Bett **Date** 8/4/14.

DETAILS OF THE SUBMISSION

ANNUAL INVESTMENT AND TREASURY MANAGEMENT STRATEGY 2014-15

1. INTRODUCTION

1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice for Treasury Management in the Public Services (the Code) requires local authorities to produce a treasury management strategy for the year ahead. The PCC is required to comply with the Code through Regulations issued under the Local Government Act 2003.

1.2 CIPFA's latest version of the Code was released in November 2011.The OPCCN has adopted specific clauses and policy statements from the Code as part of its Financial Regulations.

1.3 Complementary to the CIPFA Code is the Communities and Local Government's (CLG's) Investment Guidance, which requires local authorities and PCCs to produce an Annual Investment Strategy. This report combines the reporting requirements of both the CIPFA Code and CLG's Investment Guidance.

1.4 The primary objectives of the PCC's Investment Strategy are to safeguard the timely repayment of principal and interest, ensuring adequate liquidity and generating investment yield. The current economic and financial environment remains challenging. Interest rates remain at historic lows and concerns over the security of some financial institutions continue. The primary objectives of the PCC's Investment Strategy are to safeguard the timely repayment of principal and interest, whilst ensuring adequate liquidity for cash flow and the generation of investment yield. A flexible approach to borrowing for capital purposes will be maintained which avoids the 'cost of carrying debt' in the short term. This strategy is prudent while investment returns are low and counterparty risk (the other party involved in a financial transaction, typically a bank or building society) remains relatively high

2. THE TREASURY MANAGEMENT FUNCTION

2.1 The CIPFA Code defines treasury management activities as "the management of the PCC's cash flows, its banking, money market and capital market transactions; the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.2 The PCC is required to operate a balanced budget, which means that cash raised during the year must meet its cash expenditure. Treasury management operations ensure this cash flow is adequately planned, with cash being available when it is needed. Surplus money is invested in low risk counterparties, providing adequate liquidity before considering investment return.

2.3 A further function of the treasury management service is to provide for the borrowing requirement of the PCC, essentially the longer term cash flow planning to ensure the PCC can meet capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using internal cash balances on a temporary basis. Debt previously drawn down may be restructured to meet the PCC's risk or cost objectives.

2.4 The PCC has delegated responsibility for treasury management decisions taken within the approved strategy to the PCC CFO. Day to day execution and administration of investment and borrowing decisions is undertaken by Norfolk County Council through contractual arrangements. Day to day cash flow operations are managed by the Constabulary.

2.5 External treasury management consultancy services are provided by Capita Asset Services (formally known as Sector), providing a range of services which include:

- Technical support on treasury matters and capital finance issues.
- Economic and interest rate analysis.
- Debt services which includes advice on the timing of long term borrowing.
- Debt rescheduling advice surrounding the existing portfolio.
- Generic investment advice on interest rates, timing and investment instruments.
- Credit ratings/market information service for the three main credit rating agencies (Fitch, Moody's and Standard & Poors).

2.6 Whilst Capita Asset Services and the County Council provide support to the treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the PCC.

2.7 Performance will continue to be monitored and reported to the PCC as part of the budget monitoring report.

3. CAPITA ASSET SERVICES ECONOMIC OVERVIEW

Economic Overview

3.1 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded in quarter 1 and 2 of 2013 to surpass all expectations. Growth prospects remain strong looking forward, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. However, growth is at a lower level than in previous recoveries and there is concern as to how robust it is. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have improved this to some extent.

3.2 A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual Government deficit has been halved from its peak without appearing to do too much damage to growth.

Capita Asset Services forward view

3.3 The current economic outlook and structure of market interest rates and government debt yields have several key treasury mangement implications:

- Although Eurozone concerns have subsided in 2013, Eurozone sovereign debt difficulties have not gone away and there are major concerns as to how these will be managed over the next few years as levels of Government debt, in some countries, continue to rise to levels that compound already existing concerns. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2014/15 and beyond;

- Borrowing interest rates have risen during 2013 and are on a rising trend. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, as borrowing rates rise, the policy of internal borrowing needs to be carfully monitored in order to avoid incurring higher borrowing costs in future.

3.4 The following table gives Capita Asset Services view of UK Base Rate and Public Works Loan Board (PWLB) borrowing rates:

Quarter Ending	Base Rate (%)	PWLB Borrowing Rates (%)		
		5 year	25 year	50 year
Dec 2013	0.50	2.50	4.40	4.40
Mar 2014	0.50	2.50	4.40	4.40
June 2014	0.50	2.60	4.40	4.40
Sept 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.70	4.50	4.60
Mar 2015	0.50	2.80	4.60	4.70
June 2015	0.50	2.80	4.70	4.80
Sept 2015	0.50	2.90	4.80	4.90
Dec 2015	0.50	3.00	4.90	5.00
Mar 2016	0.50	3.20	5.00	5.10
June 2016	0.75	3.30	5.10	5.20
Sep 2016	1.00	3.50	5.10	5.20
Dec 2016	1.00	3.60	5.10	5.20
Mar 2017	1.25	3.70	5.20	5.30
Projected Increase over the 3 year period	+0.75	+1.20	+0.80	+0.90

Treasury Management Implications

3.5 This challenging and uncertain economic outlook has several key treasury mangement implications:

3.6 The key requirements of both the Code and the Investment Guidance are to produce an Annual Investment and Treasury Strategy covering the following:

- Guidelines for choosing and placing investments – Counterparty Criteria (Section 5).
- Details of Specified and Non-Specified investment types (Section 6).
- Identification of the maximum period for which funds can be committed – Counterparty Monetary & Time Limits (Section 7).

4. INVESTMENT STRATEGY 2014-15

4.1 Forecasts of short-term interest rates, on which investment decisions are based, suggest that the 0.5% Bank Rate will remain unchanged until the second quarter of 2016.

4.2 If economic growth remains strong and unemployment falls faster than expected, then the Bank Rate could be increased sooner. However, should the pace of growth slow, then rates are likely to remain unchanged for sometime, particularly if the Bank of England forecasts for the rate of fall in unemployment prove to be too optimistic.

4.3 The investment earnings rates which most closely matches the average deposit profile is the 6 month LIBID (London Intra Bank Bid rate for money market trades) forecast. The suggested budgeted interest rates for the following 3 financial years are as follows:

Financial Year	Interest Earnings Budgeted Rates
2014-15	0.600%
2015-16	0.600%
2016-17	0.925%

4.4 There are 3 key considerations to the treasury management investment process. CLG's Investment Guidance ranks these in the following order of importance:

- security of principal invested,
- liquidity for cash flow, and
- investment return (yield).

Each investment is considered in the context of these 3 factors, in that order.

4.5 CLG's Investment Guidance requires local authorities and PCCs to invest prudently and give priority to security and liquidity before yield, as described above. In order to facilitate this objective, the Guidance requires the PCC to have regard to CIPFA's Code of Practice for Treasury Management in the Public Sector.

4.6 The key requirements of both the Code and the Investment Guidance are to produce an Annual Investment and Treasury Strategy covering the following:

- Guidelines for choosing and placing investments – Counterparty Criteria (Section 5).
- Details of Specified and Non-Specified investment types (Section 6).
- Identification of the maximum period for which funds can be committed – Counterparty Monetary & Time Limits (Section 7).

5. INVESTMENT STRATEGY 2014-15 – COUNTERPARTY CRITERIA

5.1 Norfolk County Council, on behalf of the PCC, as part of its contractual arrangement, works closely with its external treasury advisors to determine the criteria for high quality institutions. The minimum rating criteria uses the 'lowest common denominator' method of selecting counterparties and applying lending limits to those counterparties (see Section 7). This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For example, if an institution is rated by all three credit rating agencies, two meet the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with the CIPFA Treasury Management Code of Practice.

5.2 The criteria for providing a pool of high quality investment counterparties for inclusion on the Council's and PCCs 'Approved Authorised Counterparty List' is provided below. Following review by the PCCs external Treasury Advisor, the criteria reflect changes from the Strategy in 2013/14. Changes are identified below, indicated by them being underlined.

- **UK Banks** which have as a minimum, the following Fitch, Standard and Poors and Moody's credit ratings:

UK Banks	**Fitch**	**Standard & Poors**	**Moody's**
Short Term Ratings	F1	A-1	P-1
Long Term Ratings	A	A	A2
Viability Ratings (Fitch)/ Financial Strength (Moody's)	bb-	-	C-
Support Ratings	3	-	-

- **Non-UK Banks (Additional facility in 2014/15)** domiciled in a country which has a minimum sovereign rating of AAA and as a minimum, the following Fitch, Standard and Poors and Moody's credit ratings:

Non-UK Banks (option 1)	**Fitch**	**Standard & Poors**	**Moody's**

Short Term Ratings	F1+	A-1+	P-1
Long Term Ratings	AA-	AA-	Aa3
Viability Ratings (Fitch)/ Financial Strength (Moody's)	bb+	-	C
Support Ratings	1	-	-

- **Part Nationalised UK Banks** – Lloyds Banking Group and Royal Bank of Scotland Group. These banks are included while they continue to be part nationalised or they meet the ratings for UK Banks above.
- **Building Societies** – Building Societies will be used which meet the UK Bank ratings outlined above.
- **Money Market Funds (MMFs)** – which are rated AAA by all three major rating agencies (additional facility in 2014/15). MMF's are 'pooled funds' investing in high-quality, high-liquidity, short-term securities such as treasury bills, repurchase agreements and certificate of deposit. Funds offer a high degree of counterparty diversification that include both UK and Overseas Banks.
- **UK Government** – including the Debt Management Account Deposit Facility & Sterling Treasury Bills (additional facility in 2014/15). Sterling Treasury Bills are short-term (up to six months) 'paper' issued by the UK Government. In the same way that the Government issues Gilts to meet long term funding requirements, Treasury Bills are used by Government to meet short term revenue obligations. They have the security of being issued by the UK Government.
- **Local Authorities, Parish Councils etc.** – Includes those in England and Wales (as defined in Section 23 of the Local Government Act 2003) or a similar body in Scotland or Northern Ireland.

5.3 The credit ratings of the PCC and Norfolk County Council's Corporate Banker (Co-Operative Bank) are currently below the minimum criteria for UK Banks above. Cash balances held with the Co-operative Bank are for account operation purposes only. Balances will be minimised in both monetary size and time. As part of its plans to re-capitalize and simplify its business, the Co-operative Bank has announced its intention to withdraw from providing banking services to local authorities. As a result the Co-operative Bank will not be seeking to renew its banking relationship with the County Council when the current banking contract expires in 2016. The County Council will consider bringing forward its timetable for seeking formal banking tenders. The Co-Operative Bank has given no such notice to the PCC for when the current banking contract ceases in 2016.

5.4 All cash invested by the PCC in 2014-15 will be either Sterling deposits (including certificates of deposit) or Sterling Treasury Bills invested with banks and other institutions in accordance with the Approved Authorised Counterparty List.

5.5 The Code of Practice requires local authorities to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for use, additional market information will be used to inform investment decisions. This additional market information includes, for example, Credit Default Swap rates and equity prices in order to compare the relative security of counterparties.

5.6 The current maximum lending limit of £10 million for any counterparty will be maintained in 2014-15 to reflect the increase in cash balances and to avoid large deposits with the DMO.

5.7 In addition to individual institution lending limits, "Group Limits" will be used whereby the collective investment exposure of individual banks within the same banking group is restricted to a group lending limit.

5.8 For 2014/15 the Strategy is extended to enable deposits beyond 365 days but only with UK banks which meet the credit ratings at paragraph 5.2. Deposits may also be placed with UK Part Nationalised Banks and Local Authorities for periods of up to 2 years.

6. SPECIFIED & NON-SPECIFIED INVESTMENTS

6.1 As determined by CLG's Investment Guidance, Specified Investments offer "high security and high liquidity". They are Sterling denominated and have a maturity of less than one year. Institutions of "high" credit quality are deemed to be Specified Investments. From the pool of high quality investment counterparties identified in Section 5, the following are deemed to be Specified Investments where the period of deposit is 364 days or less:

- Banks: UK and Non UK
- Part Nationalised UK Banks
- UK Building Societies (which meet the minimum ratings criteria for Banks)
- Money Market Funds
- UK Government
- Local Authorities, Parish Councils etc.

6.2 Non-Specified Investments are those investments that do not meet the criteria of Specified Investments. From the pool of counterparties identified in Section 5, they include:

- The PCC's Corporate Banker (Co-operative Bank).
- Any investment greater than 364 days.

6.3 The categorisation of 'Non-Specified' does not in any way detract from the credit quality of these institutions, but is merely a requirement of the Government's guidance.

6.4 The Counterparty List includes both Specified and Non-Specified Investment institutions. It is envisaged that the PCC will use specified investments only in 2014-15, other than the normal day to day transactions undertaken through the Co-operative Bank.

7. BORROWING STRATEGY 2014-15

7.1 Capital expenditure can be paid for immediately by applying capital receipts, capital grants or revenue contributions. Capital expenditure in excess of available capital resources or revenue contributions will add to the PCC's borrowing requirement. The PCC's need to borrow is measured by the Capital Financial Requirement, which represents the total outstanding capital expenditure which has not yet been paid for from either capital or revenue resources.

7.2 Borrowing relates to long term loans (i.e. loans in excess of 364 days). The borrowing strategy includes decisions on the timing of when further money should be borrowed.

7.3 The main source of long term loans is the Public Works Loan Board (PWLB), which is part of the UK Debt Management Office (DMO). The maximum period for which loans can be advanced by the PWLB is 50 years.

7.4 In accordance with the approved 2013-14 Investment and Treasury Strategy, the PCC has postponed any new borrowing for capital purposes, using cash balances on a temporary basis to avoid the cost of 'carrying' debt in the short term. Delaying borrowing and running down the level of investment balances also reduces the PCC's exposure to investment counterparty risk. This strategy will be continued in 2014/15.

7.5 Total external borrowing currently stands at £13.161 million, with an additional £15.671 million financed internally from temporary cash resources. The PCC's overall new borrowing requirement in 2014-15 is estimated at £3.8 million. The 2014-15 budget provision for interest payable is around £765,000. This covers interest on existing loan debt and the 2014-15 borrowing requirement. It is not envisaged that borrowing will be required during 2014-15 for capital expenditure financed internally since 2009-10. By financing internally there will be an interest saving of around £700,000.

7.6 The challenging and uncertain economic outlook outlined by Capita Asset Services in Section 3, together with managing the cost of "carrying debt" requires a flexible approach to borrowing. The PCC CFO, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks identified in Capita Asset Services economic overview (Section 3).

7.7 The level of outstanding debt and composition of debt, in terms of individual loans, is kept under review. The PWLB provides a facility to allow the restructure of debt, including premature repayment of loans, and encourages local authorities and PCCs to do so when circumstances permit. This can result in net savings in overall interest charges. The PCC CFO and Sector will monitor prevailing rates for any opportunities during the year.

7.8 The PCC has flexibility to borrow funds in the current year for use in future years. For example, the PCC CFO may do so under delegated powers where a sharp rise in interest rates is expected and borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the PCC CFO will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing will be undertaken to fund the approved capital programme. Risks associated with any advance borrowing will be subject to appraisal in advance and subsequent reporting through the reporting process.

8. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

8.1 There are four treasury related Prudential Indicators. The purpose of these is to restrict the activity of the treasury function to within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these indicators are too restrictive, they will impair the opportunities to reduce costs/improve performance. The Indicators are:

- **Upper Limits on Variable Interest Rate Exposure** – This identifies a maximum limit for variable interest rates based upon the debt position net of investments. It is recommended that the PCC sets an upper limit on variable interest rate exposures for 2014-15, 2015-16 and 2016-17 of 30% of its net outstanding principal sums. This is consistent with previous policy.

- **Upper Limits on Fixed Interest Rate Exposure** – Similar to the previous indicator, this covers a maximum limit on fixed interest rates. It is recommended that the PCC sets an upper limit on fixed interest rate exposures for 2014-15, 2015-2016 and 2016-2017 of 100% of its net outstanding principal sums.

- **Maturity Structures of Borrowing** – These gross limits are set to reduce the PCC's exposure to large fixed rate sums falling due for refinancing and require upper and lower limits. It is recommended that the PCC sets the following limits for the maturity structures of borrowing. These limits follow existing treasury management policy and are unchanged from 2013-14:

	Lower Limit	Upper Limit
Under 12 months	0%	15%
12 months and within 24 months	0%	15%
24 months and within 5 years	0%	45%
5 years and within 10 years	0%	75%
10 years and above	0%	100%

- **Total Principal Funds Invested for Greater than 364 Days** – This limit is set with regard to the PCC's liquidity requirements. As stated earlier in the report, it is estimated that in 2014-15 no funds will be invested for periods greater than 364 days.

9. OTHER IMPLICATIONS AND RISKS

As indicated within the report.

PUBLIC ACCESS TO INFORMATION: *Information contained within this submission is subject to the Freedom of Information Act 2000 and wherever possible will be made available on the OPCC website. Submissions should be labelled as 'Not Protectively Marked' unless any of the material is 'restricted' or 'confidential'. Where information contained within the submission is 'restricted' or 'confidential' it should be highlighted, along with the reason why.*

ORIGINATOR CHECKLIST (MUST BE COMPLETED)	PLEASE STATE 'YES' OR 'NO'
Has legal advice been sought on this submission?	NO
Has the PCC's Chief Finance Officer been consulted?	YES
Have equality, diversity and human rights implications been considered including equality analysis, as appropriate?	NOT APPLICABLE
Have human resource implications been considered?	NOT APPLICABLE
Is the recommendation consistent with the objectives in the Police and Crime Plan?	YES
Has consultation been undertaken with people or agencies likely to be affected by the recommendation?	YES
Has communications advice been sought on areas of likely media interest and how they might be managed?	NOT APPLICABLE
In relation to the above, have all relevant issues been highlighted in the 'other implications and risks' section of the submission?	YES

APPROVAL TO SUBMIT TO THE DECISION-MAKER (this approval is required only for submissions to PCC and DPCC).

Chief Executive

I am satisfied that relevant advice has been taken into account in the preparation of the report and that this is an appropriate request to be submitted to the PCC.

Signature: **Date** 8.4.14